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IN THE

Supreme Court of the United States

October Term, 1986

MARATHON OIL COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONER'S REPLY TO BRIEFS IN OPPOSITION

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Marathon Oil Company, petitioner herein, by and through its attorneys, Gibson, Dunn & Crutcher, submits this reply to the Brief For The Federal Respondents In Opposition and the Brief Of Respondent Cook Inlet Region, Inc. In Opposition ("CIRI").

ARGUMENT

I. THIS CASE DOES NOT INVOLVE A ROUTINE APPLICATION OF A LONGSTANDING REGULATION; IT INVOLVES AN ADMINISTRATIVE ORDER IN EXCESS OF STATUTORY AUTHORITY

Respondents seek to persuade the Court that this case involves a routine application of a longstanding regulation yielding a standard result. This is not correct. The action of the Secretary of Interior ("Secretary") in this case is not routine; it is unprecedented. The Secretary has adopted a novel interpretation of a longstanding regulation in order to cantilever his authority far beyond statutory bounds. In so doing the Secretary has sought by administrative fiat to replace the Mineral Leasing Act's (MLA) mandate to collect a "royalty" with a mandate to collect a net-profits interest, which is the antithesis of a royalty. The Solicitor General asserts that the Secretary's novel extension of the regulation "presents no issue of general importance warranting review by this Court." *Federal Brief*, at 7. To the contrary, this case concerns fundamental national policy regarding management of mineral resources on public lands. It directly affects all federal oil and gas lessees who use oil or gas as feedstock for such manufactured products as plastics, fertilizer and refinery products. It also has far-reaching importance for judicial review of administrative agency action that departs from congressional mandates expressed in language having a clear commercial meaning.

II. THE SECRETARY LACKS AUTHORITY TO COLLECT A NET-PROFITS INTEREST

The MLA instructs the Secretary to collect a "royalty" on production from federal leases. *Pet.*, at 4; *Federal Brief*, at 2. A net-profits interest is not a royalty. *Pet.*, at 11; *Federal Brief*, at 10, n.6. The Secretary is seeking to collect a net-profits interest from Marathon. The Solicitor General's own counterstatement

of the Question Presented concedes this. The Solicitor General states the issue as whether the Secretary may value gas on the basis of the sale price of a manufactured product, liquefied natural gas, "less allowable costs and deductions for liquefaction and transportation (*including return on investment*)." *Federal Brief,* at I. When the Secretary can determine rate of return, the government captures a portion of Marathon's profits. The lower the rate of return allowed on Marathon's investment, the greater the government's share of Marathon's profits. The Secretary has claimed in the district court that a reasonable rate of return on Marathon's LNG facilities is between 8% and 8.6%, far below what could have been earned by investing in Treasury securities. The Secretary was quite candid in the Ninth Circuit about his intent to capture a share of Marathon's entrepreneurial profits, claiming that this is an inevitable result of the regulation's gross proceeds language. *See Pet.,* at 5, n.3 (quoting *Brief for the United States*).

To effectuate the capture, the Secretary has extrapolated from the statute, which specifies a royalty, and from the regulation, which speaks of gross proceeds from the sale of leasehold production, to an administrative order that demands a share in profits earned solely from a manufacturing and transportation enterprise. There is no sale of production in Japan; sold there is a manufactured product, LNG.[1] The Solicitor General and CIRI try to obscure the point that no leasehold production is sold in Japan by emphasizing the "gross proceeds" sentence in the regulation. The problem masked

[1] LNG is not synonymous with natural gas. *See Pet.,* at 4, n.2. The district court tried to equate the two, *see* 604 F. Supp. at 1386, *Pet. App.,* at 44a, but in so doing inadvertently resolved a genuine issue of material fact against the party opposing summary judgment, Marathon, and against the only evidence before it on this issue (evidence presented by Marathon). The Ninth Circuit recognized the problem, *see* 807 F.2d at 767, *Pet. App.,* at 13a-14a, and tried unsuccessfully to circumvent it by saying the district court did not have to reach the issue.

thereby is whether the government is entitled to collect gross proceeds on sales of a manufactured product or on sales of raw gas produced at the leases. Marathon does not quarrel with the right of the Secretary under the regulation to obtain a share of the gross proceeds from the sale of the gas at the leasehold. Indeed, that is precisely the longstanding construction applied by the Secretary between 1923 and the beginning of the current dispute with Marathon.[2] *See Pet.*, at 10-11; *see also Memo* of Sept. 10, 1979 from John Duletsky, Acting Chief, USGS Conservation Division (Admin. Rec. 124) ("Geological Survey has no authority or need to control costs accruing downstream from the lease meter."); *USGS Conservation Division Manual*, §§ 647.2.3A, 647.7.5F (Release No. 35, Aug. 15, 1977) (describing same policy). But when the Secretary abandoned that construction and sought to share in profits from downstream manufacturing and transportation, he overreached himself; he cannot turn a statutory royalty into a net-profits interest by transmuting the regulation. He could not amend the regulation to require a net-profits interest explicitly; he cannot accomplish the equivalent by an order "interpreting" the gross proceeds sentence in the regulation. That it is reasonable to use gross

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[2] The two cases the Solicitor General relied on for the proposition that net-back is "well established and accepted in the industry," *Federal Brief*, at 9, are the product of very special circumstances not present here. The lease form in Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950) gave the Secretary unfettered discretion to establish royalty values. Terming the lease provision as "extraordinary," the court held the Secretary's determination was valid absent "fraud or mistake so gross as to imply bad faith." 184 F.2d at 821. No claim is or could be made that the Secretary has unlimited discretion in this case.

Ashland Oil, Inc. v. Phillips Petroleum Co., 554 F.2d 381 (1975) concerned a private action over the value of helium intermixed with natural gas. Helium, though purchased by the government in a stockpiling program, had no market price; the price of the natural gas was fixed by the Federal Power Commission. Under those circumstances the court allowed use of a "work-back" methodology because there was no other way to determine value. The Mineral Leasing Act and Secretarial discretion were not involved.

proceeds from the sale of leasehold *production* as a surrogate for royalty value does not mean that "gross proceeds" equals "net-profits."

The MLA's mandate to the Secretary is precise: to take necessary and proper actions to collect a royalty It is not, as CIRI suggests, to take all necessary and proper actions to obtain a reasonable financial return from public lands. If this Court compares the MLA's clear instruction to the Secretary to collect a royalty with the net-profits interest commanded by the Secretary's order it will see that the Secretary has acted beyond his statutory authority.

III. DEFERENCE IS NOT APPROPRIATE WHEN AN AGENCY EXCEEDS ITS AUTHORITY AND WHEN ITS INTERPRETATION IS INHERENTLY UNRELIABLE

As explained above and in the petition for certiorari, *Pet.*, at 9-12, the MLA's mandate is narrow. The Secretary's authority and discretion is limited in all respects to the collection of a "royalty," a term with a single accepted commercial meaning. *Id.; Amicus Brief of the American Petroleum Institute*, at 3-6. The Court of Appeals evaded the question of whether the Secretary's interpretation of the regulation could be squared with the statute's mandate by invoking the doctrine of deference. The Solicitor General concedes that deference is not appropriate when an agency acts beyond the scope of its authority, and he agrees that courts should apply various criteria to determine whether the agency's interpretation is reliable before deferring. *Federal Brief*, at 10-11. The Solicitor General's *post hoc* rationalization of reliability cannot now cure the failure of the court below to consider those criteria. Contrary to the Solicitor General's assertions, the Secretary's interpretation of the gross proceeds language of the regulation to create a net-profits interest is new and unprecedented. The Department of Interior's Minerals Management Service does

not have expertise in the task it has undertaken — collection of a net-profits interest using a ratemaking methodology. Finally, the Secretary does not have broad policymaking authority here either. The authority bestowed on him by Congress is to collect only a royalty, a portion (in kind or value) of oil and gas produced from public lands. Therefore, deference to the Secretary's legal interpretation was improper.

IV. CONCLUSION

Denial of certiorari will leave standing a precedent for the Interior Department to graft a net-profits interest onto the gross proceeds language of the regulation and onto the venerable term "royalty" in the Mineral Leasing Act. More important, it will greatly expand the "deference" principle explained in *Chevron*, making the administrative function of determining royalty valuation a specialized matter "committed to agency discretion," virtually unreviewable by courts. These are matters of importance both to the orderly administration of the mineral leasing laws and to the allocation of authority between the executive and the judiciary to interpret the law.

WHEREFORE, Marathon Oil Company respectfully requests that this Court grant its petition for certiorari.

Dated: March 1987.

Respectfully submitted,

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